

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: May 25, 2004

To: The Commission
(Meeting of May, 27, 2004)

From: Alan LoFaso, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: **AB 2918 (Laird) - Desalination facilities: electricity rates.**
As amended May 17, 2004

Legislative Subcommittee Recommendation: Support, if Amended to delete references to exemption from energy crisis costs and authorize desalination plants to seek special rate consideration on the basis of water policy reasons.

Summary: This bill would require the Commission to consider a special rate classification for desalination plants operated by publicly- or investor-owned water districts, as specified.

Digest: Existing law, P.U. Code sec. 451, requires that all charges demanded or received by any public utility for a product or commodity be just and reasonable.

Existing law, Water Code secs. 80100 et seq., authorized Department of Water Resources (DWR) purchases of electricity on behalf of electric customers, provided financing of specified costs via bonds and charges, and suspension by the Commission of direct access until specified conditions are met.

This bill would state legislative findings regarding the need for additional fresh water sources in California, new technological improvement leading to cost-effective desalination, and that the cost of electricity contributes to the high cost of desalination.

This bill would require the Commission initiate a proceeding by July 1, 2005 to determine the feasibility of establishing a separate rate class for a public agency- or regulated utility-owned desalination plant by examining the costs and benefits of exempting these entities from specified energy crisis-related electricity costs, and other specified benefits. This bill would apply to desalination plants placed into service in 2006 or later and authorize the Commission to incorporate the proceeding into utilities' general rate cases.

Analysis: AB 2918 proposes that the Commission consider a special rate class for desalination plants owned by water districts that receive electricity from investor-owned electric utilities as bundled customers on two grounds:

1. The water needs of California auger in favor of electric rates that enable desalination.¹ The author has suggested that up to 75% of the cost of desalination comes from electricity.
2. Energy crisis electrical costs should not be borne by desalination plants because the technology was not contemplated to be feasible when power projections were made in 2001, upon which many of these costs were based. Although the bill addresses several energy crises costs, the author has most specifically made this point regarding the DWR-related charges associated with these costs.

Regarding the first argument, the Commission's Water Division concurs with the facts presented in the bill's findings and agrees with the policy proposition that favorable electric rates will make desalination more cost effective and will greatly reduce state's water supply problem especially in coastal regions. Water Division also suggests that some level of subsidization may be involved. The bill's last finding—"(e) The Public Utilities Commission should not shift costs as a result of the enactment of this act"—may contradict some aspects of rate design, which can involve cost-shifting among bundled customers.

The second argument raises more serious concerns. The Energy, Strategic Planning, and Administrative Law Judge Divisions have expressed concerns regarding this approach. Although rate design incorporates principles of cost causation, all bundled customers are ultimately responsible for costs that are recoverable in rates. This particular argument that a substantial portion of an electric corporation's portfolio can be attributed to one subset of bundled customers and not another, because of a circumstances related to time, is unprecedented and could have unforeseen implications. Notwithstanding the DWR or energy crisis issues, this argument, if taken too far, could have different sets of utility consumers seeking to attach themselves to lower cost portions of the utility's portfolio to seek a rate cut.

Moreover, prior Commission have determined that all customers (new or existing)

¹ According the analysis of the Assembly Water, Parks, and Wildlife Committee, "[t]here are two technologies being developed [for desalination]. One is reverse osmosis, in which seawater is forced through a membrane, filtering out the salts and other impurities. The other is distillation, in which seawater is turned to steam, then condensed into pure, fresh water. The least expensive process, and therefore the most widely studied, is reverse osmosis.

"Desalination does have a few drawbacks. It is still expensive, relative to other sources of water. It is highly energy-intensive. There is also the problem of disposing of the brine produced in the desalination process.

"However, innovative siting arrangements, such as building desalination plants together with power plants, will create economies for both types of facilities. Water from the desalination plant can be used for cooling the power plant, for example, while electrical transmission costs are eliminated."

should pay for the DWR costs. Under current Commission ratemaking policy, when investor-owned utilities (IOUs) serve additional demand, historical undercollections can be spread more widely, so each customer pays a smaller share than if new load were exempted. As for DWR costs, DWR is reimbursed for all power that is considered to have been supplied by DWR contracts.

Procedural Issues:

AB 2918 requires the Commission to initiate a proceeding to consider rate design issues for desalination plants by July 1, 2005 or consider these issues in the utilities' next general rate cases (GRCs). Utilities rate cases are likely to be completed by just this time. Therefore, if the Commission were to fold this issue into GRCs, this rate design issue might not be addressed until the completion of the next GRC cycle.

There is no deadline in the bill, and it would only apply to desalination plants in service on or after January 1, 2006. Folding all or a portion of these issues into GRCs would comply with this and the bill's other provisions.

LEGISLATIVE HISTORY

Assembly Floor: 41-28 (pass) (5/20/04)

Assembly APPR.: 18-2 (Do pass as amended) (5/12/04)

Assembly W. P. & W.: 14-0 (Do pass as amended) (4/20/04)

Assembly U.&C.: 8-4 (Pass) (4/19/04)

SUPPORT/OPPOSITION

Support: None on file.

Opposition: None on file.

LEGISLATIVE STAFF CONTACT

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BILL LANGUAGE:

BILL NUMBER: AB 2918 AMENDED
BILL TEXT

AMENDED IN ASSEMBLY MAY 17, 2004
AMENDED IN ASSEMBLY APRIL 27, 2004
AMENDED IN ASSEMBLY APRIL 15, 2004
AMENDED IN ASSEMBLY APRIL 12, 2004

INTRODUCED BY Assembly Member Laird

FEBRUARY 20, 2004

An act to add Section 747 to the Public Utilities Code, relating to desalination facilities.

LEGISLATIVE COUNSEL'S DIGEST

AB 2918, as amended, Laird. Desalination facilities: electricity rates.

Under existing law, the Public Utilities Commission has regulatory authority over public utilities, including electrical corporations, and authorizes the commission to fix just and reasonable rates and charges for all public utilities.

This bill would, for any electrical corporation serving more than 1,000,000 customers, require that by July 1, 2005, the commission initiate either a quasi-legislative or ratesetting proceeding to determine the feasibility of establishing a separate rate class for desalination plants operated by public agencies or by regulated utilities, which are placed in service after January 1, 2006.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. The Legislature finds and declares all of the following:

(a) The state has serious water supply problems which will be difficult to solve without additional supplies of clean fresh water.

(b) Some methods for addressing fresh water shortages raise very controversial issues, including the environmental effects of new dams used to store additional supplies, purchasing water from agricultural interests, and shipping water from one part of the state to another.

(c) Desalination has recently become more cost effective as a result of recent technological improvements, although desalination is not free of difficult policy and environmental issues.

(d) Fresh water provided by desalination will remain costly, partly because of the cost of electricity used in the desalination process.

(e) The Public Utilities Commission should not shift costs as a result of the enactment of this act.

SEC. 2. Section 747 is added to the Public Utilities Code, to read:

747. The commission shall, by July 1, 2005, for any electrical corporation serving more than 1,000,000 customers, initiate either a quasi-legislative or ratesetting proceeding to determine the feasibility of establishing a separate rate class for desalination plants operated by public agencies or by regulated utilities, which are placed in service after January 1, 2006. The commission may make the determination in the utility's next general rate case. In the proceeding, the commission shall determine the costs and benefits associated with exempting ~~public agencies or regulated utilities operating a desalination facility~~ a *desalination facility operated by a public agency or regulated utility* from costs of electricity procured through the Department of Water Resources pursuant to Division 27 (commencing with Section 80000) of the Water Code, or through any historical procurement costs associated with restructuring of the electrical industry, including any utility undercollections or insolvency or bankruptcy related charges, both during and after the energy crises of 2000-01. In the proceeding, the commission shall additionally consider whether a desalination facility employs programs to shift electricity consumption to offpeak electricity demand periods, including interruptible or curtailable service programs, and use of real time metering.